Fiscal Policy and Macroeconomic Stability in Nigeria: How Effective are Fiscal Rules?

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Abstract

The paper examines the impact of fiscal rules on macroeconomic stability in Nigeria. Using data spanning 2005Q1-2021Q4, the study adopts the Autoregressive Distributed Lag (ARDL) approach and constructs output volatility to account for the role of gross fixed capital formation (GFCF), tax revenue, government size, and trade openness in assessing macroeconomic stability. The findings reveal that, Nigeria has deviated from the established rule limits since 2017. The study also finds that increase in government size and GFCF are instrumental to attaining macroeconomic stability during economic crisis. On the other hand, increasing trade openness and taxation are inimical to the macroeconomic stability of import-dependent economies with low levels of production. Hence, the study recommends that government should establish an independent fiscal council with the mandate to monitor and ensure adherence to established rule limits and review the existing rule-based framework to remove ambiguities and be anchored on robust institutional mechanisms that are in line with best practices.

Keywords: macroeconomic stability, fiscal rules, government size
JEL Classification : E60, E63, H50, H20

I. Introduction

A stable macro economy is premised upon robust economic fundamentals, backed by sound public financial management and fiscal policy frameworks that are resilient to shocks and distortions. This is attained where there is a strong commitment by fiscal authorities at ensuring prudent management of public resources, while driving economic growth and raising the living standards of the citizens.

Over the last two decades, fiscal authorities have become increasingly aware, and are making conscious efforts to curtail the use of discretionary fiscal policy through the adoption of fiscal rules. In this regard, regional, national, and sub-national governments set long-term restrictions on fiscal policy using numeric parameters on budgetary aggregates (Schaechter et al., 2012). In doing so, it is hoped to limit the scale and impact of macroeconomic shocks and create more fiscal space to undertake additional expenditure when the need arises.

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